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SUBJECT: NEPAL'S BUDGET: BROAD PROMISES, UNREALISTIC ASSUMPTIONS

Summary

¶1. (U) The Government of Nepal recently unveiled its policies and programs for fiscal 2009/10, and a USD 3.7 billion budget to support them, with the aim of, among other things, fostering faster economic growth, curbing inflation, boosting infrastructure development, and expanding social services to the downtrodden, all while moving the ongoing peace process forward. Widespread criticism of these proposals from business leaders, economists, leading lawmakers from its 22-party coalition, and many others, indicate that the new Communist Party of Nepal-United Marxist Leninist-led government is off target. The general consensus among critics is that the Government lacks the capacity necessary to fulfill the plethora of promises it has made.

Policies and Programs Promise Something for Everyone

¶2. (U) On July 9, President Ram Baran Yadav presented the Communist Party of Nepal-United Marxist Leninist (UML)-led government's annual programs and policies to parliament, giving top priority to completion of constitution drafting, state restructuring and economic growth. He pledged that Nepal's new constitution will be completed "on the basis of national consensus" before the May 2010 deadline, federalism would be institutionalized and a strong "socialism-oriented" economy that emphasizes public-private partnerships would be created. In his 94-point overview of the Government of Nepal's (GON's) priorities for fiscal year 2009/10, which began on July 16, the President also promised that law and order would be strengthened and "impunity will be eliminated."

¶3. (U) While improved governance and economic performance were emphasized, the Government's program and policies, which were formally endorsed by parliament on July 12, contain sweeping promises for almost every sector of Nepali society. At one point during his presentation, Yadav vowed, "All legitimate demands put forward by the workers, peasants, women, youths, students, teachers, professors, intellectuals, doctors, engineers, lawyers, civil servants, journalists, entrepreneurs, cultural artists, the landless, the squatters, the conflicted affected, the displaced, freed bonded laborers, the haliyas (agricultural bonded labors), badis (the lowest formerly "untouchable" caste), and the disabled will be gradually fulfilled through mutual dialogue."

Big Budget Proposed to Fulfill Big Promises

¶4. (U) The GON has proposed a Rs. 285.9 billion (USD 3.7 billion) budget in support of its policies and programs.

Introduced on July 13, it is nearly 34 percent larger than the FY 2008/09 budget and more than double the amount the government spent two years ago. Finance Minister Surendra Pandey said the government expects to raise Rs.176 billion in revenues, 24 percent above the record level of revenues collected by the previous Maoist-led government. The balance of financing for the budget will come from increased foreign loans and domestic borrowing. The government, which took power in May, anticipates receiving Rs. 56.9 billion (USD 739 million) in foreign grants, a 64.7-percent increase, and Rs. 21 billion (USD 273 million) in bilateral and multilateral loans, more than double the amount received last year. It is estimated that the budget deficit will still total Rs. 52.4 billion (USD 680 million), 43 percent more than the estimated deficit for FY 2009/10.

15. (U) In his budget address, Pandey reiterated that drafting a new constitution was the government's top priority, and he pledged that "there will be no shortcoming in financial or other resources for the Constituent Assembly (CA)" to complete the task. There is no line item in the budget specifically earmarked for this purpose, but it does budget a total of Rs. 770 million (USD 10 million) to the CA to carry out both its legislative and constitution-writing responsibilities. Last year, Rs. 723 million was initially allocated to the CA, but, according to the most recent estimates, it spent Rs. 743 million (USD 9.6 million, based on the current exchange rate.)

16. (U) The largest share of the budget, 45.6 percent, is earmarked for social services, including education, which

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accounts for 16.3 percent of total spending. According to Pandey, the budget will ensure the "fundamental right" of easy access to education for all citizens. Transportation, agriculture, electricity and other "economic services" account for 23.2 percent spending. Defense and police will each receive slightly more than 5 percent of total spending, while 10 percent will go to servicing loans. Overall spending is higher, but the share of spending for each general budget categories is largely unchanged from FY 2008/09.

Infrastructure Targeted

17. (U) The GON plans to make a massive investment in infrastructure improvement and development in FY 2009/10, emphasizing roads, irrigation and electricity production and distribution. Road construction, upgrading and maintenance are budgeted at Rs. 18.5 billion (USD 240 million), a 68-percent increase over spending the previous fiscal year. This includes Rs. 252.3 million (USD 3.3 million) to begin construction of the Kathmandu-Nijgasdh Fast Track, a mega-road project designed to cut travel time between the Kathmandu Valley and the Terai, the country's industrial and agricultural heartland. Aiming to increase agricultural production and boost employment, The government allocated Rs. 7.9 billion (USD 102 million) for irrigation projects.

18. (U) Pandey announced that the GON is formulating plans to develop at least 25,000 megawatts (MW) of hydropower capacity, about 40 times Nepal's current capacity, over the next 20 years. The Rs. 14.7 billion (USD 190 million) budgeted for the energy sector includes funds to begin construction of the 130MW Upper Seti project and to carry out feasibility studies of four other large-scale projects. The government also plans to repair and extend electrical transmission lines, including construction of new lines that will allow greater imports from India, (Comment: Last year, the Maoist-led government launched a 10-year plan to add 10,000 MWs of hydropower capacity, but failed to initiate a single project during its nine months in power. The latest estimates show that the former government spent less than half of the Rs. 12.7 billion it had allocated for the energy

sector.)

After Dismal Year, Lofty Economic Goals Set

¶9. (U) Implementation of the proposed budget, according to Pandey, will boost economic growth and slash inflation. He said the government's goal is to increase the gross domestic product (GDP) by 5.5 percent in FY 2009/10, while cutting inflation to 7 percent. The day before his budget speech, the Finance Ministry released its annual economic survey, showing that, based on data from the first eight months, the economy grew by just 3.9 percent in FY 2008/09, compared to 5.3 percent in the previous year. The consumer price index rose 12 percent, up from 7.7 percent the previous year.

¶10. (U) Growth in the agricultural sector, which accounts for about one third of the total GDP, fell to 2.1. percent, less than half the previous year's rate. The non-agricultural sector grew by 4.8. percent, compared to 5.7. percent in FY 2007/08. The Ministry blamed slow agricultural growth on adverse weather and attributed the non-agricultural sector's weak performance to the energy crisis, "bandhs" (strikes) and other problems. Pandey predicted that the agricultural sector will grow by 3.3 percent in FY 2009/10, while the non-agricultural sector will expand by 6.6 percent.

Faint Praise Accompanies Loud Criticism

¶11. (U) The GON's economic projections for the new fiscal year have been questioned by many people, including Biswambhar Pyakurel, a leading economist, who accused government officials of making its projections "without doing their homework." Pyakurel said the government failed to take into consideration the impact of global economic crisis, in particular its potential affect on remittances from overseas workers. Remittances from workers currently account for about 17 percent of the total GDP, not including those working in India, but some projections indicate that they

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will to fall to 13 or 14 percent of GDP as a result of the economic crisis, according to Pyakurel. He added that, while the government may be able to gain "some control" over inflation, "there is no way Nepal can obtain 7-percent inflation."

¶12. (U) Business leaders hailed certain policies and programs, including elimination of both the tax on scrap and the development tax of 1.5. percent and the 25-percent reduction in the prevailing highest customs duty raise, but they have roundly criticized the government for not doing enough to create an environment for investment and wider economic growth. Kush Kumar Joshi, President of the Federation of Nepalese Chambers of Commerce and Industry, lambasted the government moving ahead with the Kathmandu-Nijgasdh Fast Track on its own despite the private sector's desire to participate in the project, saying it was an indication that the government is not committed to fulfilling its promise of greatly expanding greater public-private partnerships. UML lawmaker and leading businessman Binod Kumar Chaudhary agreed: "The budget has failed to encourage industrialists."

¶13. (U) Joshi, Chaudhary and others criticized the budget for failing to support the government's pledge to bring an end to bandhs and to strengthen overall governance. Chaudhary said, "Increasing capital expenditure alone will not be enough in the context of weak governance." Economist Pyakurel concurred that the number of projects the government plans to undertake is "unmanageable" due to weak governance, especially at the district and village level. Nepali Congress lawmaker and former finance minister Ram Sharan Mahat also cited weak governance as a major obstacle when he

questioned whether the government's budget could be implemented during the first day of budget deliberations.

Comment

¶14. (U) Budget deliberations are ongoing. There is no statutory deadline, but they are commonly completed within a month of the start of the parliament's budget session, which, this year, was July 8. Given that the GON is counting on receiving more than USD 2 billion in foreign grants and loans to close the projected gap between revenues and expenditures, the USG should anticipate being approached by Nepali officials with hat in hand, seeking increased bilateral assistance, support in securing funding from international financial institutions or, most likely, both.

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